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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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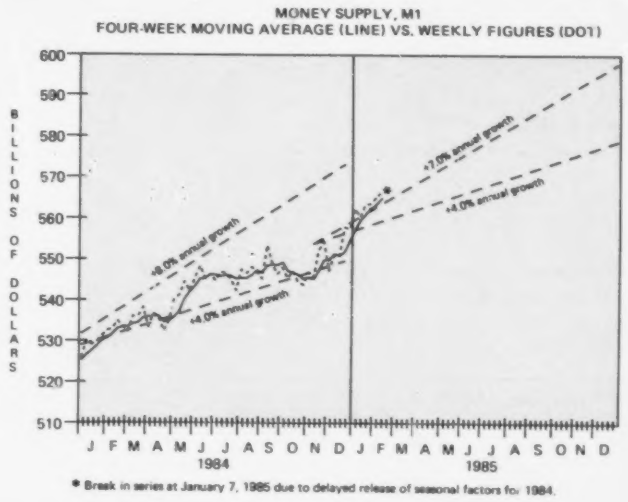
Chairman Volcker's Testimony . . .
In recent days, the attention of the financial markets has been riveted upon both the deliberations of the Federal Reserve's policy-setting Federal Open Market Committee and the Congressional testimony of Federal Reserve Chairman Paul A. Volcker, as they search for clues to the likely course of monetary policy. And, while the outcome of the recent FOMC meeting is not yet known, the testimony of Chairman Volcker is more straightforward—highlighting as usual Fed expectations of future business, price and financial market developments.

As in past years, the Fed Chairman cautioned against the persistence of exceptionally large Federal budget deficits and excessive money creation, not to mention the inflationary implications of both. But despite these warnings, there were few surprises in the testimony, reflecting the fact that the United States continues to enjoy a robust, non-inflationary business expansion.

Although the Fed's view of the economy is generally less upbeat than the Administration's—pointedly referring to several potential, longer-term problems—there are in fact few signs on the horizon which would suggest a termination of today's business expansion and/or an acceleration in the rate of inflation. For one thing, consumer sentiment remains too bright and personal incomes growth too strong for a prolonged pause in consumer spending. For another, inventory levels are still lean and hefty capital spending plans remain to be implemented. This suggests that the economy may well be on the threshold of faster, rather than slower growth. This notion has been enhanced in recent days by the release of statistics dealing with consumer spending, housing starts and building permits. Nor does inflation pose any imminent danger. With energy prices softening, the dollar remaining exceptionally strong in the foreign exchange markets and wages growth modest at best, it appears a good bet that even more progress in curbing inflation may be in the offing.

. . . Suggests That Monetary Policy . . .
With neither growth nor price concerns warranting any abrupt switch in the Fed's monetary policy, further policy initiatives—whether easing or tightening—will be put on hold for now. But other than a major change in the dollar's external value, one complication which could arise in this otherwise "serene" picture is the pronounced pickup in money supply growth in recent weeks. Although the Fed Chairman expressed his belief that as the year unfolds, "growth will slow consistent with the target ranges" (without stating, of course, the time limits



to central bank tolerance of above-target money numbers or, for that matter, what would happen if those time limits are exceeded), in recent months the monetary aggregates have been expanding at rates not seen since mid-1983. So far, the central bank has been reluctant to undertake any direct action against these money supply bulges, especially with inflation rates so low and the foreign exchange market value of the dollar so strong.

However, warnings of the undesirability of excessive money growth should be, and are, taken seriously in the financial markets. The growth of M1, for example, is clearly accelerating; over the past 15 weeks, it has surged at an annual rate in excess of 15 percent from its late-October low point (see chart). So, too, the growth rates of M2 and M3 have picked up, surpassing 13 percent, at an annual rate in January—well above any conceivable, interim growth targets. To be sure, one reason for today's above-

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target, M1 money numbers is the fact that the Fed undershot the midpoint of its 1984 target range. While this has prompted suggestions from some quarters that the Fed change the starting point for the growth of M1 this year if above-target money numbers are not to become a problem all year long, others remain less convinced that such a sleight of hand would be appropriate. These people believe that steps should be taken to curtail the rapid growth of bank reserves, money supply and total credit. For now, neither the base nor the M1 target range has been altered, but last fall's easing actions to stimulate money growth have been terminated.

. . . Will Not Change Anytime Soon

While control of money supply growth remains an important public policy objective, effective control of the Federal budget deficit remains elusive—a fact bemoaned by the Fed Chairman and credit markets alike, and one which continues to cloud the outlook for longer-run rates of inflation and interest. What is more, so much attention is now being focused on prospects for fiscal year 1986 that the massive size of the fiscal 1985 red-ink total, and the borrowing requirements to match, are often overlooked. With spending in general, and interest outlays in particular soaring, the budget deficit totaled a hefty $72 billion during the first quarter of fiscal 1985—$9 billion more than that amassed during the first quarter of fiscal 1984 and even larger than that posted during the first three months of fiscal 1983. At that time, Washington's deficit hit a record $195

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 2/20/85	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	166.269	+ .921	+ 9.060
Loans to Depository Inst.	.994	– .101	+ .360
Float	.966	+ .246	– .036
Total Reserve Bank Credit	179.662	+ .112	+12.857
Treasury Deposits with Federal Reserve Banks	3.819	– .978	– 1.045
Currency in Circulation	178.700	+ .221	+11.273
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	117.145	+ .919	+ .495
	2/13/85		
Member Bank Reserves:			
Total Reserves Held	40.541	+ .168	+ 2.977
Excess (Deficiency)	1.022	+ .243	– .172
Net Free Reserves	.724	+ .399	+ .184
		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates†			
M1 (2/11/85)	567.4	‡	‡
M2 (January '85)	2,400.1	+ 14.0	+ 9.0
M3 (January '85)	3,027.9	+ 14.0	+ 11.3
Domestic Nonfinancial Debt (3rd Q'84)	5,760.0	+ 11.7	+ 12.9

†Seasonally adjusted. * Seasonally adjusted annual rate. ‡ Data unavailable due to revisions.

New York Money Market

Offering Rates 2/22/85	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	8.35%	8.48%	8.60%
* Federal Agencies	8.53	9.09	9.39
* Project Notes–Taxfree (46% Taxable Equivalent)	7.87	8.33	8.61
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	8.85	9.30	10.00

‡ Finance Company Paper–Prime		‡* Bankers' Acceptances	
5- 14 days	8.40%	Mar.	8.70%
15- 29 days	8.45	Apr.	8.75
30- 59 days	8.50	May	8.85
60- 89 days	8.55	Jun.	8.90
90-179 days	8.58	Jul.	8.95
180-239 days	8.65	Aug.	8.95
240-270 days	8.65		

‡ Industrial Paper–Prime			
30- 89 days	8.53%	†Federal Funds Effective Rate	8.50%
90-120 days	8.55		

‡ Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'84	$ 3,764r	$ 3,695	$ 3,432
Gross National Product (1972 Dollars)*	4th Q'84	$ 1,665r	$ 1,645	$ 1,573
Percent Change, Annual Rate	4th Q'84	4.9r	1.6	5.9
Change in Consumer Prices*	Dec '84	2.4%	2.4%	2.4%
Change in Producer Prices*	Jan '85	0.0%	2.4%	8.4%
Civilian Employment (Thousands of Persons)†	Jan '85	106,391	106,273	103,294
Unemployment as % of Civilian Labor Force†	Jan '85	7.4%	7.2%	8.0%
Personal Income*	Jan '85n	$ 3,130	$ 3,114r	$ 2,897
Leading Indicators Composite Index (1967=100)†	Dec '84	164.9	165.2	163.4
Industrial Production Index (1967=100) †	Jan '85	166.6	165.9	158.5
Net Change in Consumer Installment Credit †	Dec '84	$ 6.95	$ 7.95	$ 5.78
U.S. Merchandise Trade Balance †	Dec '84	–$ 8.20	–$ 9.94	–$ 6.74
Plant and Equipment Expenditures*	1st Q'85	$337.85(a)	$321.40(a)	$293.15
Private Housing Starts (Thousands of Units)*	Jan '85n	1,833	1,595r	1,933r
New Construction Expenditures*	Dec '84	$ 318.7	$ 316.0	$ 263.9
Total Business Inventories †	Dec '84	$ 566.5	$ 565.0	$ 514.3
Total Business Sales †	Dec '84	$ 416.9	$ 414.5	$ 395.7

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

billion for the entire fiscal year, and it appears a good bet that a new record is within reach this year.

Although narrowing the Federal deficit remains a top priority of the Administration, achieving this objective will be quite difficult, especially in light of the facts that tax increases have been ruled out, Social Security is considered virtually untouchable, only modest defense cuts can be expected and nothing can be done about the rapid rise in interest costs. Indeed, if a credible deficit reduction program is not put in place soon, soaring interest outlays alone may ensure that 12-digit budget deficits become a permanent feature of the U.S. financial landscape. And, as Chairman Volcker pointed out, with economy-wide credit growth continuing to outrun the rate of expansion of the overall economy, potentially damaging inflation rate consequences could result.

Thus, with the economy expanding briskly, fears of a so-called "growth recession" virtually buried, money growth accelerating and little substantive action being taken so far to produce a credible deficit reduction program, the Fed is going to put further loosening initiatives on hold. This will probably preclude further declines in short-term interest rates for now. And as the expansion of economy-wide credit demands gets under way in earnest later this year, it would seem as though higher, rather than lower rates are in store. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (2/6/85)	156,344	– 392	+14,535
New York City (2/13/85)	33,139	– 154	+ 4,540
Commercial Paper (2/13/85)	245,637	+ 1,016	+56,664

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (2/6/85)	251,809	+ 2,057	+ 26,861
New York City (2/13/85)	62,136	+ 191	+ 4,374

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (2/6/85)	655,457	+ 3,561	+ 72,430
New York City (2/13/85)	141,590	– 243	+ 8,407

Financial Markets

	Friday 2/22/85	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	8.66%	+ .21	– .44
180-Day Bills†	9.02	+ .31	– .24
Longest Bills†	9.42	+ .32	+ .12
Recent Issues:			
10s 2/28/87 (When Issued)	10.37	NA	
10⅝s 12/31/88	11.09	+ .37	
11¼s 2/15/95	11.76	+ .36	
11¼s 2/15/15	11.70	+ .35	
Municipals:			
Bond Buyer–20 Bond Index* (2/21/85)	9.71%	+ .07	– .09
Blue List Total ($ Million)	$1,972	+ $175	+ $ 556
30-Day Visible Supply ($ Million)	$2,674	– $164	+ $ 754
Total	$4,646	+ $ 11	+ $1,310
Corporates:			
Moody's Aa Composite (2/21/85)	12.61%	+ .21	– .18
30-Day Visible Supply ($ Million)	$1,345	+ $350	– $1,795
Stocks:			
Dow-Jones Averages:			
Industrials	1,275.84	– 6.18	+ 110.74
Transportation	625.11	– 4.10	+ 114.22
Utilities	149.67	– 1.18	+ 24.62
65 Stocks	520.65	– 3.00	+ 64.70
Standard and Poor's 500 Stocks	179.36	– 2.24	+ 21.85
N.Y.S.E. Composite Index	104.01	– 1.26	+ 13.52
N.Y.S.E. Avg. Daily Vol. for Week (000's)	101,580	–19,296	+ 10,222

* 46% Taxable equivalent 17.98%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 2/22/85	Week Ago
Overnight	8.50%	8.50%
1 month	8.81	8.50
3 month	9.31	8.88
6 month	9.81	9.38
1 year	10.56	9.94
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	11.65%	11.25%
Long Term (7 to 15 yrs.)	11.75	11.45

FOREIGN EXCHANGE SPOT RATES

New York Opening (2/22/85)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01471	67.9850
Canada	.7273	1.3750
Denmark	.08292	12.0600
France	.09676	10.3350
Germany	.2959	3.3790
Italy	.0004755	2103.00
Japan	.003808	262.60
Mexico	.004202	238.00
Netherlands	.2610	3.8310
Switzerland	.3509	2.8495
U.K.	1.0783	.9274

Manufacturers Hanover completes another record year.

Extracted from a letter to shareholders by John F. McGillicuddy, Chairman.

"I am very pleased to report that our corporation's earnings reached a new high in 1984. In fact, our net income of $352.5 million represents this institution's 12th consecutive year of record results.

"Fourth quarter earnings totalled $106.2 million, an increase of 23 percent over last year's fourth quarter. Even more significant was the fact that our earnings per share for this period reached $2.14 up from $2.13 a year ago and $1.59 in the third quarter of 1984. This means that the dilution resulting from the issuance of common and preferred stock—both related to the acquisition of CIT Financial Corporation—has been reversed, and in only nine month's time.

"A major factor in this reversal was that CIT's performance more than lived up to expectations. Since it was acquired on May 1st, CIT has contributed $31.7 million to our bottom line—that, after all charges for interest-related financing costs and the amortization of the purchase premium. On a pro forma basis, had CIT been with us for the full year instead of only eight months, it would have contributed approximately $45 million. We expect CIT will contribute at an even higher level in 1985.

"Other highlights of the year worth noting include:

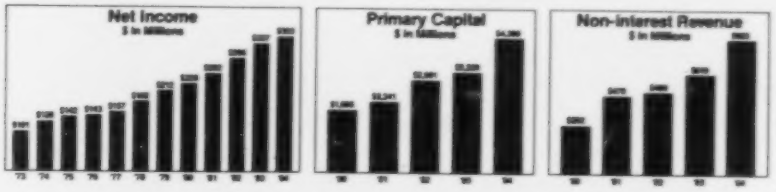
"A 35.7 percent increase in primary capital, up $1.2 billion to $4.4 billion. This brought our ratio of primary capital to assets to 5.77 percent, up from 5.01 percent a year ago. In the past three years, we have added $2.2 billion to our primary capital base.

"A $198 million addition to our reserve for possible loan losses. This 45.8 percent increase in our reserves came after absorbing a record $259.2 million in net loan charge-offs. This means that despite the impact of a grossly uneven economic recovery, both at home and abroad, we were able to absorb our losses out of current earnings even as we bolstered our reserve by an additional $198 million. At year's end, our reserve totaled $630.7 million, representing a ratio of reserves to total loans of 1.08 percent, up from .90 percent a year ago.

"A 33 percent increase in other operating income to $823 million. This $204 million improvement means that we continue to derive an ever-growing share of our revenues from fee-based services that make little or no claim on our capital ratios. Improvements came in virtually all sectors of our business, but were particularly strong in the areas of foreign exchange trading, securities trading and investment banking.

"On the international scene, progress continued to be made during the year, with a major debt restructuring for Mexico and with Argentina reaching agreement with the International Monetary Fund and major creditor banks. The result was a partial payment of past-due interest by Argentina at year's end. Despite this payment, our earnings for the year were reduced by $36.3 million after-tax by the impact of certain nonaccrual Argentine loans.

"Our strong performance in the fourth quarter, particularly given the challenges we faced, provides us with a great deal of momentum as we enter 1985."



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A full earnings report and complete financial statements are available pending publication of the 1984 Annual Report and 10-K in early March. Write Manufacturers Hanover Corporation, Corporate Communications Dept., 270 Park Avenue, New York, NY 10017.

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